



April 30, 2014
Company Report
Rating: BUY
TP: HK\$ 690*

H-Share price (HK\$)	509.5
Est. share price return	35.43%
Est. dividend yield	0.35%
Est. total return	35.77%

Previous Rating & TP	BUY; 690
Previous Report Date	Mar. 25, 2014

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*TP is calculated based on the no. of shares before the proposed 1-to-5 share split; share split w.e.f 15/05/14.

Key Data

52Wk H/L(HK\$)	646/259.6
Issued shares (mn)	1,865
Market cap (HK\$ mn)	950,218
3-mth avg daily turnover (HK\$ mn)	3,836.6
Major shareholder(s) (%):	
Naspers Limited	34.02
Ma Huateng	10.25

Source(s): Company, Bloomberg, ABCI Securities

FY13 Revenue breakdown (%)

VAS	74.4
Online advertising	8.3
Ecommerce transactions	16.2
Others	1.0
Total	100.0

Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	(4.77)	(6.53)
3-mth	(6.26)	(8.15)
6-mth	18.88	22.52

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg

Tencent (700 HK) Cooperate with Hollywood for streaming service

- Cooperate with Warner Brothers to provide streaming service will strengthen Tencent's revenue potential as well as help offset recent impacts of media censorship by the Chinese government on share price
- Fundamental factors remain unchanged while Tencent's shares become less expensive with revaluation of the TMT sector
- We maintain our **BUY** rating with TP at HK\$ 690, reflecting 0.95x FY14E PEG

Cooperate with Hollywood to provide Netflix-like streaming service. The Group is working with Warner Brothers, one of the most influential film studios in the world, on a Netflix-like streaming service to counteract piracy in China. Movies of Warner Brothers will be provided to its streaming service users at prices as low as \$1. Generally, most Hollywood movies are first shown in theatres before releasing on DVDs and finally, the online distribution services. However, piracy activities in China have made profiting much more difficult for the distributors. The proposed streaming service could potentially be a lucrative revenue stream leveraging on Tencent's huge user base.

Negative impact of online media censorship is temporary. The Chinese government stripped Sina of its publication and distribution licenses on April 24 to intensify its lewd content crackdown. Currently, China does not have a well-defined film classification system and in general prohibit all forms of adult content in the media, although the official definition of the adult content remains unclear. Most internet media tend to define the terms on their own. Though the revoking of Sina's licenses does not have any direct impact on Tencent, it does raise concerns about the potential restrictions that that the Group may face in developing its online media business. However, we believe the negative effect is temporary and will not significantly decrease the Group's revenues from media and advertising.

Maintain BUY with TP at HK\$ 690. Recent dip in the TMT sector has significantly reduced Tencent's valuation from 0.81x (on Mar 25, 2014) to 0.7x FY14E PEG. We believe Tencent's fundamentals are still solid and considering the Group's leading position in TMT, high ROE and fast-growing ecommerce business, we believe its current valuation is still highly attractive. Maintain **BUY** with TP at HK\$ 690, reflecting 0.95x/0.58x FY14E/FY15E PEG.

Risk factors: 1) Regulatory risks concerning media censorship, online financial services and payments; 2) Disappointing monetization from WeChat and increasing marketing costs; 3) Intensifying competition among domestic ecommerce companies; 4) Slowdown in PC gaming sector; (5) High stock volatility in an overheating internet sector; (6) Post-M&A risks.

Results and Valuation

FY ended Dec 31	2011A	2012A	2013A	2014E	2015E
Turnover (RMB mn)	28,496	43,894	60,437	86,031	121,206
Chg (%.yoy)	45.05	54.03	37.69	42.35	40.89
Net Income (RMB mn)	10,203	12,732	15,502	22,943	34,840
Chg (%.YoY)	26.69	24.78	21.76	48.00	51.85
EPS (RMB)	5.49	6.83	8.30	12.17	18.30
Chg (%.YoY)	26.85	24.46	21.45	46.61	50.42
BVPS (RMB)	15.32	22.16	31.02	40.35	55.88
Chg (%.yoy)	29.22	44.72	39.96	30.07	38.49
DPS (HK\$)	0.75	1.00	1.20	1.77	2.65
P/E (x)	-	-	47.96	32.72	21.75
P/B (x)	-	-	12.83	9.87	7.12
Yield (%)	-	-	0.24	0.35	0.52
ROE (%)	40.63	36.50	31.24	34.24	38.19
ROA (%)	17.96	16.92	14.46	19.29	21.82

Source(s): Bloomberg, ABCI Securities estimates

Consolidated income statement (2011A-2015E)

FY Ended Dec 31 (RMB mn)	2011A	2012A	2013A	2014E	2015E
IVAS	23,043	31,995	44,985	58,458	74,322
MVAS	3,271	3,723			
Online advertising	1,992	3,382	5,034	7,048	10,219
e-Commerce transactions	0	4,428	9,796	19,592	35,266
Others	190	365	622	933	1,400
Revenues	28,496	43,894	60,437	86,031	121,206
Cost of revenues	(9,928)	(18,207)	(27,778)	(39,540)	(50,906)
Gross profit	18,568	25,686	32,659	46,491	70,299
SG&A	(7,204)	(10,759)	(15,683)	(23,345)	(30,301)
Other income and gains	(735)	(123)	(2,305)	(1,055)	(1,161)
Pre-tax profit	12,099	15,051	19,281	24,200	41,159
Income tax	(1,874)	(2,266)	(3,718)	(3,630)	(6,174)
Net profit	10,225	12,785	15,563	23,039	34,985
Profit attributable to:					
Minority interests	22	53	61	95	145
Equity holders of the Company	10,203	12,732	15,502	22,943	34,840
EPS (Basic), RMB	5.61	6.97	8.46	12.28	18.47
EPS, Diluted, RMB	5.49	6.83	8.30	12.17	18.30
DPS, HK\$	0.75	1.00	1.20	1.77	2.65

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2011A-2015E)

As of Dec 31 (RMB mn)	2011A	2012A	2013A	2014E	2015E
Fixed assets	5,885	7,403	8,693	10,694	13,484
Intangible assets	3,780	4,719	4,103	5,138	6,255
Interests in associates	4,433	7,310	12,170	9,740	10,955
Other non-current assets	7,203	19,315	28,583	27,080	30,481
Total non-current assets	21,301	38,747	53,549	52,651	61,174
Inventories		568	1,384	2,939	5,290
Accounts receivable	2,021	2,354	2,955	5,162	8,484
Prepayments, deposits and other assets	2,212	3,878	5,365	4,621	4,993
Cash and cash equivalents	12,612	13,383	20,228	33,536	57,844
Other current assets	18,659	16,326	23,754	20,040	21,897
Current Assets	35,503	36,509	53,686	66,298	98,508
Total assets	56,804	75,256	107,235	118,949	159,683
Accounts payable	2,244	4,212	6,680	8,603	10,909
Other payables and accruals	5,014	6,301	10,246	11,184	14,545
Borrowings	7,999	1,077	2,589	1,833	2,584
Current income tax liabilities	709	420	1,318	869	1,093
Deferred revenue	5,016	8,115	11,841	4,989	8,415
Other short-term liabilities	200	540	593	567	580
Total current liabilities	21,183	20,665	33,267	28,044	38,125
Borrowings		2,106	3,323	3,323	3,323
Long-term notes payable	3,733	7,517	9,141	8,329	8,735
Deferred income tax liabilities	940	1,312	1,441	924	946
Long-term payables	1,860	1,509	1,600	1,554	1,577
Total non-current liabilities	6,533	12,443	15,505	14,130	14,581
Total liabilities	27,716	33,108	48,772	42,175	52,706
Total equity	29,088	42,148	58,463	76,774	106,977
Non-controlling interests	625	851	518	684	601
Equity of the firm	28,464	41,298	57,945	76,090	106,375
BVPS, RMB	15.32	22.16	31.02	40.35	55.88

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2011A-2015E)

FY ended Dec 31 (RMB mn)	2011A	2012A	2013A	2014E	2015E
Profit for the year	10,225	12,785	15,563	23,039	34,985
Adjustments for:					
Income tax expense	1,874	2,266	3,718	3,630	6,174
Dividend income	–	(407)	(509)	(458)	(484)
Depreciation of fixed assets and investment properties	1,208	1,880	2,484	2,182	2,333
Amortization of intangible assets	726	733	1,106	919	1,013
Interest income	(469)	(836)	(1,314)	(873)	(1,008)
Equity-settled share-based compensation expenses	733	905	1,168	1,718	2,381
Changes in working capital:					
Accounts receivable	(251)	(267)	(606)	(2,207)	(3,323)
Inventories	–	(301)	(815)	(1,555)	(2,351)
Prepayments, deposits and other receivables	(2,630)	(2,255)	(940)	744	(372)
Accounts payable	828	1,689	2,036	1,923	2,305
Other adjusted items	2,951	5,461	5,601	3,541	5,427
Net Cash generated from operating activities	15,194	21,654	27,492	32,603	47,082
Income tax paid	(1,836)	(2,225)	(3,118)	(3,564)	(6,061)
Net cash flow generated from operating activities	13,358	19,429	24,374	29,039	41,021
Cash flow from investing activities					
Payments for business combinations, net of cash acquired	(1,444)	(435)	4	(215)	(106)
Purchase fixed assets, construction in progress & investment properties	(4,060)	(3,657)	(4,788)	(2,956)	(3,872)
Payments for interests in associates	(3,529)	(3,668)	(4,456)	(4,062)	(4,259)
Purchase/prepayment of intangible assets	(788)	(869)	(1,200)	(1,035)	(1,117)
Receipt from maturity of term deposits with initial term of over 3 months	5,989	18,532	15,950	17,241	16,595
Interest received	415	626	536	581	558
Dividends received	20	440	551	495	523
Other adjusted items	(11,958)	(27,239)	(25,731)	(26,550)	(26,223)
Net cash flow used in investing activities	(15,355)	(16,270)	(19,134)	(16,501)	(17,900)
Cash flow from financing activities					
Proceeds from short-term borrowings	6,683	983	2,320	1,651	1,986
Proceed from long-term borrowings	0	2,215	2,846	4,555	3,701
Net proceed from issuance of long-term notes	3,761	3,768	1,847	2,807	2,327
Proceeds from issuance of ordinary shares	160	238	308	273	291
Dividends paid to the Company's shareholders	(838)	(1,108)	(1,468)	(1,288)	(1,378)
Other adjusted items	(5,392)	(8,483)	(4,145)	(7,178)	(5,661)
Net cash flow (used in)/generated from financing activities	4,373	(2,386)	1,708	822	1,265
Net increase in cash and cash equivalents	2,376	773	6,948	13,360	24,386
Cash and cash equivalents at beginning of the year	10,408	12,612	13,383	20,228	33,536
Exchange losses on cash and cash equivalents	(172)	(2)	(103)	(53)	(78)
Cash and cash equivalents at end of the year	12,612	13,383	20,228	33,536	57,844

Source(s): Company, ABCI Securities estimates

Financial ratio table (2011A-2015E)

FY Ended Dec 31	2011A	2012A	2013A	2014E	2015E
Gross Profit Margin, %	58.52	55.00	54.04	58.00	58.00
Operating Margin, %	43.00	35.27	31.76	28.32	34.10
Net Margin, %	35.81	29.01	25.65	26.67	28.74
ROE, %	40.63	36.50	31.24	34.24	38.19
ROA, %	17.96	16.92	14.46	19.29	21.82
Total Liability/Total Asset, %	48.79	43.99	45.48	35.46	33.01

Source(s): Company, ABCI Securities estimates

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2009-2013

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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